

Livestock Market Update – and What to Do About It¹

Lee Meyer

In the fall of 2001, profit prospects for 2002 looked good for Kentucky’s livestock sector. U.S. production levels for pork and beef had moderated. Both hog and cattle prices had been at profitable levels and were expected to stay there. Since then, a variety of factors have caused cattle and hog prices to decline. The key factor has been total domestic meat supplies, but other factors have contributed as well.

The Meat Supply Situation and Demand

A year ago, the total meat supply was expected to decline modestly in 2002, primarily because of lower beef production. Analysts expected the beginning of a cow herd expansion, to pull heifers out of the feedlot chain and reduce beef supplies. Drought in the west pushed more cows to market and discouraged heifer retention, leading to more rather than less beef. And then there was the poultry situation. Not only did production expand by three percent, but exports crashed leaving more chicken on the domestic market.

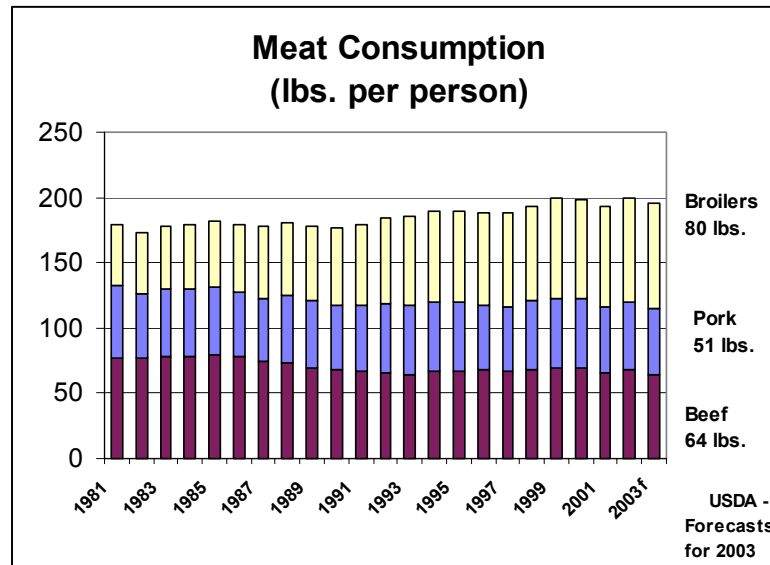


Figure 1

¹ This paper is part of the *Agricultural Situation and Outlook, Fall 2002*, publication number ESM-28, published by the Department of Agricultural Economics at the University of Kentucky with an additional contribution from Kentucky State University in October 2002. The entire publication can be accessed on the WWW at http://www.uky.edu/Ag/AgEcon/pubs/esm/esm_28.pdf.

This article presents information on the economic situation and outlook for Kentucky agriculture and is intended to assist farmers, agribusiness professionals, Extension field staff, and others with interest in agriculture and agribusiness. Information presented here is based on the most recent information and research available. However, the rapidly changing economic and policy conditions for agriculture limit the usefulness and life span of conclusions and recommendations cited here. Decision makers should keep these facts in mind. Feel free to use the information included in this publication for other uses, but please provide professional citation about the source. This paper is published without formal review and the views expressed are those of the authors and do not necessarily reflect the views of the University of Kentucky, the Agricultural Experiment Station, or the Cooperative Extension Service.

If you need additional information or if you would like to provide comments or suggestions about this paper, please contact Lee Meyer at lmeyer@uky.edu.

As a result, total meat production for 2002 increased by seven pounds. This put downward pressure on all types of meat products. Wholesale prices declined – beef by 7%, pork by 30% and broiler by 10%, although retail beef and pork prices did not change very much. The lower wholesale prices resulted in lower bids for slaughter cattle and hogs, but near steady retail prices did not encourage increased consumption. The exception was chicken – leg quarter prices went from \$.34/lb. to \$.18/lb. during the past year. A confusing technical factor is the source of the retail price information – reported prices are based on regular prices, not specials. During the past year, retailers ran specials with deep discounts on some cuts which did help move product.

Broilers – Prices Slammed by 2002 Export Crash

U.S. chicken production increased by three percent in 2001, and then by another three percent in 2002. Normally, that would have been a good match with increases in demand, however export demand plummeted when Russia embargoed U.S. chicken. While the stated reason for the trade barrier was food safety concerns, most analysts believe that the real cause was to retaliate for the U.S. steel tariff. Regardless, the embargo placed almost 700 million more pounds of chicken on the domestic market.

The industry is likely to recover in 2003. Trade has reopened to Russia and other markets have been found. For 2003, production is expected to increase by two percent and prices should return to the levels seen in 2001. In spite of the higher prices, profitability will suffer from increased corn prices, which makes up about half of the ration.

Kentucky is currently the 10th largest broiler producing state, Georgia is first and Delaware is just ahead of Kentucky. According to the USDA’s NASS, Kentucky cash receipts from broilers are over \$500 million. UK poultry specialist Tony Pescatore estimates Kentucky’s 2002 production at near 270 million birds and expects production to continue to increase slowly as processing capacity in existing plants is more fully utilized.

Hogs – Low Prices this Fall, But Better Prices for 2003

Last year, 2001, was good for the hog industry. Prices were modestly higher than a year earlier, averaging about \$45 per cwt. (live weight basis). With production costs in the upper \$30s, the enterprise was profitable.

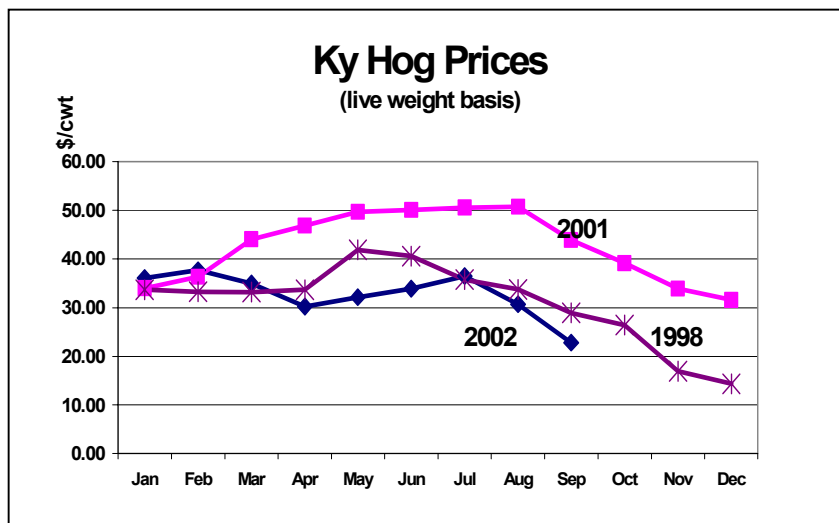


Figure 2

However, profits and structural changes in the industry stimulated a 3% increase in 2002 production and caused lower prices for the year. Slaughter hog market prices were down about \$3/cwt. in the first quarter, but were more than \$15/cwt. lower in the last six months (shown in figure 2). Increasing corn prices are driving production costs up to about \$40/cwt. This is having a damaging effect on the industry. The 30 percent price drop from July to early September was unexpected and leads to concerns about prices later this fall and early winter. Producers are worried that they could experience a situation similar to that of 1998, when prices were in the low teens and below \$10 per cwt. for short periods of time at some markets.

The focus of the industry is on processing capacity for this fall, the time when prices tend to be at their yearly low. Ron Plain, Univ. of Missouri analyst, estimates processing capacity at 380,000 head per day. Production this fall may approach those levels, but is unlikely to actually reach them. Currently hog slaughter is at a high level, partially a result of shifting production from the future. This will reduce production levels later this fall. Actual 2002 prices, along with forecasts for the rest of 2002 and for 2003 are shown in Figure 3. These predictions assume only modest increases in slaughter, thus production for 2003 is expected to show little change from the 2002 level.

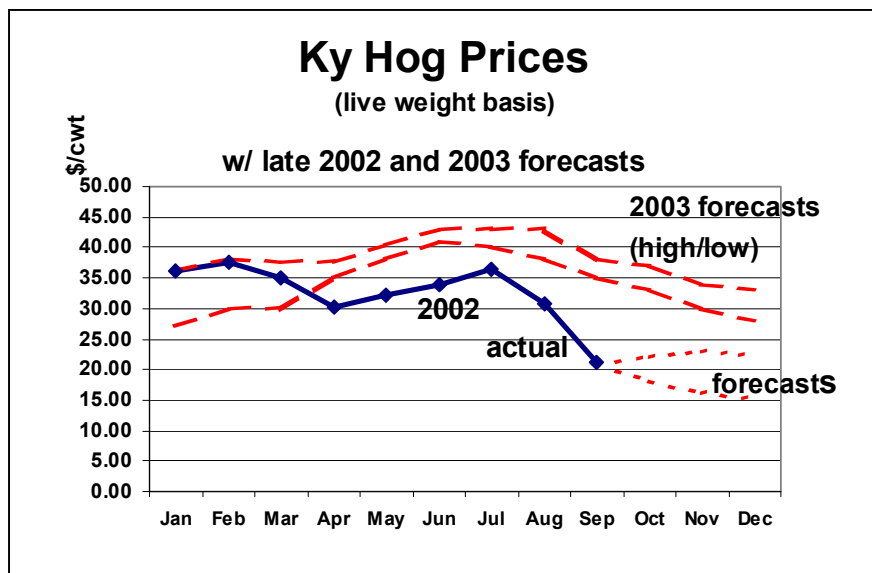


Figure 3

The September Hogs and Pigs report shows increases in market hog numbers, but a drop in sow inventories and longer run farrowings. Increased hog numbers will lead to lower prices for the first quarter of 2003, but reductions in production from the lower number of sows farrowing will improve prices later in the year. Futures markets offer opportunities to hedge 2003 marketings at price levels high enough to cover cash expenses. Converted to a live weight basis, as of late September, prices for early 2003 could be locked in at the low \$30s, with summer prices in the mid \$40s (\$60/cwt. on a carcass weight basis).

The role of the hog enterprise in Kentucky agriculture has shifted. Thirty years ago, there were 1.2 million hogs on 35,000 Kentucky farms. Now, there are about 430,000 hogs on just over 1,000 farms. In 1971, receipts from hogs made up about 10% of Kentucky's farm income, about one-third that of beef cattle. In 2001, hog income added less than 3% to farm receipts and was one-fifth of the beef cattle income. Increases in production costs, environmental concerns, lack of access to markets and low prices are key factors pressuring hog producers. Recent efforts to target Kentucky's pork production toward branded products may create opportunities for the more innovative managers.

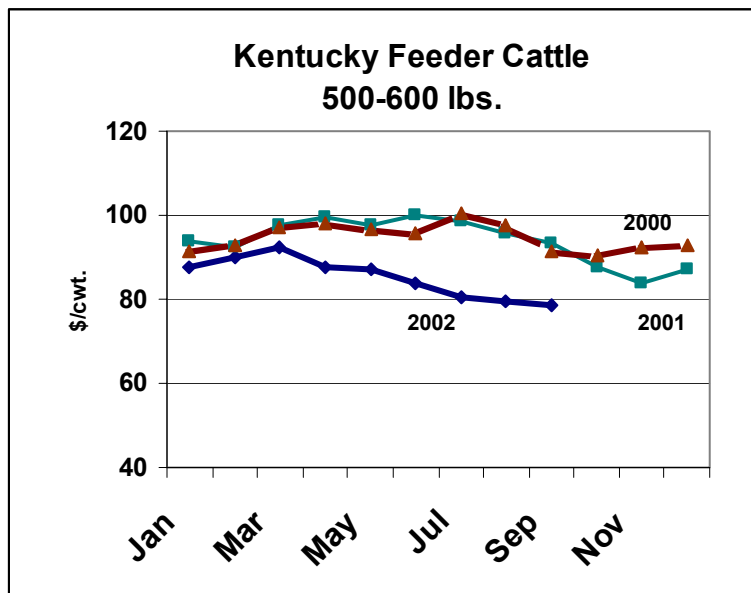


Figure 4 Cattle – Prices Down, But Likely to Rise

Feeder cattle prices follow a very strong seasonal pattern of declining prices in the fall from increased marketings. However, the drops in 2002 were not due to these seasonal factors. Instead, drops in the value of slaughter cattle moved back through the system to reduce the demand for feeder cattle

Feeder cattle prices have been below the levels of the past two years. The causes are fairly straightforward - large meat supplies hurt beef prices. The 7 billion pounds of beef produced in the July – September quarter was record large. Wholesale beef prices, or “cut out” values, have been \$10 per cwt. or more under last year’s levels. Slaughter cattle prices have been trending down for the past 18 months. Prices were in the upper \$70s in the first part of 2001, but declined by \$10 for the second half of last year. In 2002, prices continued moving downward, falling into the low \$60s during the summer. The result has been nearly two years of feedlot losses (at times over \$100 per head) and weak demand for feeder calves. The five year average premium paid for yearling steers over slaughter steers is \$5 to \$12 per cwt. (depending on the time of the year). The margin was \$15/cwt. this summer, but is declining, but still above normal for the fall.

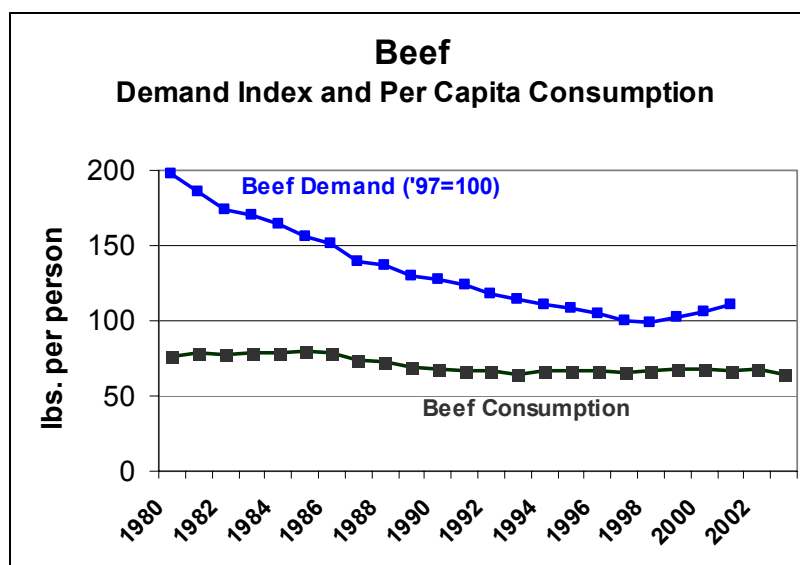


Figure 5 Beef Demand Index and Per capita Consumption

For feeder cattle prices to increase, wholesale beef and slaughter cattle prices will have to move up. For this to happen, demand must strengthen and/or supplies must decline. Demand is consumers' willingness to pay for a given amount of product on the market. The graph shows the declines in beef demand over the past 20 years. Based on an index with 1997 as the base = 100, demand was twice as high in 1980. As consumers turned to other meats for reasons of price, convenience and health perceptions, demand declined. Only in 1999 did the situation change as attitudes, products and incomes changed. Preliminary indications for the first half of 2002 suggest that demand has been stable. Given the problems with the economy, this is comparatively good news.

The supply situation is also changing. The most recent USDA Cattle on Feed report listed the number of cattle in feedlots at seven percent below last year. As current heavy cattle are moved out, production will begin to decline. The timing, fall or winter, is debated, but there is a general expectation for slaughter cattle prices to move into the upper \$60s. Spring 2003 futures market contracts are trading in the low \$70s. While stronger slaughter prices will help feeder cattle prices, increases in feed costs will apply negative pressure. There is roughly a 7:1 negative response on yearling feeder steer prices from a change in corn price. In addition, the price spreads between light and heavy feeders gets narrower as corn prices increase. The price of corn in Omaha has gone from \$1.88 per bushel last year to \$2.63. If the supply of feeders was large, the full impact of the corn price would have cut feeder prices by \$5 to \$8 per cwt. But instead of this \$5 to \$8 per cwt. drop, the tight feeder cattle supply has supported feeder cattle prices at higher levels.

The most likely price scenario is for small price declines this fall, with small price increases are forecast for next year. Slaughter cattle prices are forecast to return to the mid \$70s in the second quarter of 2003. This should add \$5 to \$10/cwt. to feeder cattle prices, with overall prices higher than 2002, but still below the 2000 level.

Marketing and backgrounding options are riskier than usual in this price environment but the potential profits are quite good. Short term conditioning programs (45 to 60 days) are likely to be profitable, especially if the calves can be marketed in a value-added program, such as CPH-45. The profitability of longer term backgrounding programs will depend on spring markets and the impact of feed costs on markets. There is typically a \$12 - \$15 per cwt. negative spread between the price of steer calves in November and yearling steers in April. Because of the current low feeder calf price, that margin is more likely to be in the \$9 to \$12 range. With a \$10/cwt. negative margin and corn priced at \$2.75 per bushel, backgrounding returns are projected at \$50 to \$80 per head.

Longer Run Outlook – It appears that the cattle cycle is dead. That is not true, and producers will eventually respond. However, drought in the West, market declines and the spike in feeding costs are likely to hold the U.S. cow herd near current levels. Cow slaughter, which had dropped below last year's level, has been running higher since June. With both large numbers of cattle in feedlots and a declining cow herd, the supply of feeder calves has declined for the past six years. This trend cannot be quickly reversed. In fact, an increase in heifer retention to build the cow herd will reduce calf supplies even more.

Because there are many factors other than the cattle cycle which affect feeder cattle prices, it is not certain that prices will increase. However, there is a strong likelihood that feeder cattle prices will be at current or higher levels for the next three to five years. While prices have declined from 2000 levels, given all of the negative economic factors (weak economy, large supplies of competing meats, increasing corn price), prices are at reasonable levels for well-managed operations to cover their costs.

University of Kentucky, Department of Agricultural Economics
400 Charles E. Barnhart Bldg., Lexington, KY 40546-0276

Phone: 859-257-5762, Fax: 859-323-1913

URL: <http://www.ukv.edu/Ag/AgEcon/>